California Management Review

CORPORATE SOCIAL RESPONSIBILITY

Reassessing the Boundaries of Government

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EU's move to tax windfall profits of energy companies reflects the growing imperative and needs of the time.

INSIGHT | FRONTIER 14 Nov 2022

Recent economic developments have reopened the debate on the government's role in the affairs of private enterprises in market economies. European Union (EU) leaders have responded to elevated energy prices, caused by Russia's invasion of Ukraine, with a **plan to redistribute extraordinary profits from energy companies to poor households and vulnerable firms**. Retail electricity prices in the EU have jumped by almost 50 percent on a year-on-year basis from July 2021 and are likely to hurt the poorest families which are bracing themselves for a difficult winter, on top facing elevated cost of living. The plan put forth by EU policymakers **could redistribute as much as $136 billion**. To fund it, the European Commission is advocating a tax **of at least 33 percent** on oil and gas companies. Furthermore, electricity companies that do not use gas but are earning windfall profits would face a levy, as the EU sets a threshold electricity price **at less than half the current market rates**. While how the EU plan would be implemented, is far from clear, what appears to be an isolated intervention event is becoming more frequent in a world of heightened political, economic, and social uncertainty. While multiple valid arguments have been made against increasing government interventions, we will maintain that such actions are both essential and beneficial, not only to civil society but also to the corporations in question.

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A central tenet of modern **liberal democracies** is that both government and private enterprises pursue the common objective of bolstering economic growth and social welfare. Market economies are organized with corporations directly engaged in the production of private goods and services. The government is responsible for the institutional apparatus and provision of public goods designed to remedy **market failures** and social conflicts. Furthermore, it extends to its citizens the **civil rights** that define liberal democracies. Despite these well-delineated functions and objectives, the question remains: how much a government should intervene in the affairs of private enterprises? Adam Smith would say that the best interest of society is fulfilled through individual selfinterest and freedom of production and consumption. Some would extend Smith's view and cite the concept of less "less is more," that is, the government's best contribution is that of no interference, leaving those who suffer to learn from their own mistakes. At an extreme, governments should play no role in the affairs of private enterprises and let them grow, diminish, or perish based on market forces. The counterargument is that demanding totally free markets is basically demanding freedom from rules and oversights. Meanwhile, some claim that free or fair competition never exists and is a utopian dream because companies are always trying to eliminate rivals in pursuit of monopolistic profits.

Soaring energy prices create a perfect storm to reassess the role and boundaries of state's power, insofar as such a scenario sends governments on a collision course with at least some corporations. In this case, energy companies would claim that energy prices are market risk factors prevalent in any business, as are any other commodity prices. Energy prices are determined by a myriad of factors that are not directly controlled by the actions of individual corporations. Stated simply, private-sector energy firms did not cause the war between Russia and Ukraine, so taxing their profits simply because market conditions boosted their earnings would be unfair government intervention. In a similar vein the onset of the COVID-19 pandemic boosted demand for stationary bicycles and teleconferencing solutions. Yet, nobody advocated for taxing the profits of Netflix, **Peloton**, and **Zoom** to redistribute them to businesses requiring in-person attendance, such as movie theaters and gymnasiums, that were hurt by lockdowns.

Unlike companies, the main stakeholders of which are shareholders, government's constituents are the entire population of a country. A government's broad objective is minimizing economic and social conflicts in the interest of the entire population. Taxing the profits of companies that benefitted from war-driven market conditions is not much different from other redistribution policies that governments undertake at other times. For example, when the US government supported the development of mRNA vaccines via **Operation Warp Speed**, it redistributed economic resources from some constituents (taxpayers) to a few corporations. Its objective was to improve the welfare of its constituents, insofar as the public health crisis could have led to **unbelievably worse outcome in a world without vaccines**. So, if redistributing resources from some constituents to biotech firms is acceptable, why isn't redistributing resources from a small group of energy firms to highly vulnerable households a suitable plan of action? Besides the moral aspect of the argument, worsening living conditions could lead to a variety of undesirable consequences, which could have a negative impact on the entire economy, including the energy firms whose profits are being taxed.

Supporting the redistribution argument is the fact that many non-gas utility companies, that would now be paying extraordinarily more taxes, would not have survived had they not received numerous government subsidies and concessions over the past few years. Think of wind, solar, and nuclear power plants. Could they have survived on their own if government did not support them with favorable regulations, subsidies, demand guarantees, low-interest loans, and price assurances? Isn't it now their payback time to save people from freezing during harsh winters?

And this is not just an isolated instance. We believe that government interventions in private industry are likely to increase, at least in the near future. It would be a reasonable outcome of the increasing geopolitical and **economic-policy uncertainty**. Consider the **Brexit** referendum that impacted not just the United Kingdom, but also continental European and American companies; the increase in **vote shares of populist parties** in Europe since the Great Recession of 2007-2009 which has transformed the traditional left-right schism to one opposing the mainstream parties; and **partisan conflict in the Unites States that has led to Congressional gridlock and high fiscal policy uncertainty.**

Fundamental factors could be driving these political outcomes. Despite the US economy doing well on average since the Great Recession, particularly on the labor market front, **household incomes have hardly grown in** real terms. More importantly, **economic inequality**, whether measured through gaps in income or wealth between richer and poorer households, has widened dramatically. Demographic trends point to declining **intergenerational social mobility**. **Inner cities** in the US face an increasingly higher level of **poverty and unemployment** and lower investments than coastal cities. The demographics of the aging population elevate the importance of **healthcare services** and a **social safety** net. But breakthrough medical innovations require substantial, risky investments, that corporations would not undertake without profit motives. Even after a few risky investment succeed to produce right drugs, many, if not most, individuals would not be able to afford such innovations because of impeditive prices that are necessary to reward risk-taking by pharmaceutical companies. In Europe, **asylum seekers and economic migrants entering without a visa** or a confirmed asylum status have sparked bitter debates about social integration, culture, values, security, and national identity.

As such, vulnerable segments of the population with voting power may increasingly demand greater intervention and redistributive policies from their elected officials. In this case, "less is more" would unlikely hold with voters. The general trends described so far have been magnified by the COVID-19 pandemic and the Russian attack on Ukraine. Two principal outcomes that affect the most vulnerable segments of societies are inflation (soaring prices of essentials such as housing, rents, utility, and food prices) and supply chain disruptions. Essentials are either not available or are getting pricier and pricier. As a result, governments could take extreme actions by. For example, reversing trade policies, increasing protectionism, and supporting domestic manufacturing.

Economists have long argued that reducing frictions to international trade and allowing countries to specialize in activities in which they have **a comparative advantage**, makes the entire world better off. Nineteenth-century economist **David Ricardo** promoted the idea that instead of trying to produce everything, each region must produce goods in which it has a comparative advantage, for technological progress and society's general welfare. Over the last thirty years, many regions have emerged with specialized skill sets and competencies. For example, California's **Silicon Valley** became the pioneer in new digital business ideas, Boston developed into a hub for biotechnology start-ups, Taiwan turned into a global leader in **semiconductor foundries,** China's **Shenzhen region** is the foremost ecosystem for manufacturing electronic products, and India's Bangalore and Hyderabad metros started employing millions of software coders.

While regional specialization may have been the optimal solution from a market standpoint, some trading principles have been shaken by the COVID-19 pandemic and the Russian attack. Almost any modern product involving electricals and electronics has at least one part crisscrossing Chinese borders at some stage of its production. China's zero-COVID policy means that the value chain for that product could either be blocked or delayed unpredictably. Russia and Ukraine together were among the largest global suppliers of raw materials, minerals, fertilizers, food, oil, and gas. The Russian attack created disruptions and uncertainties in global supply chains. Management precepts, such as just-in-time inventory planning, now seem to belong to a distant past era. Post-pandemic uncertainty, unequal access **to COVID vaccines**, and the non-participation of the Organization of the Petroleum Exporting Countries (OPEC) cartel to lower oil prices have elevated distrust and geopolitical tensions. These factors, combined with economies still struggling from the aftermath of COVID, have disproportionately affected the most susceptible segments of society.

The resultant anger and frustration are bound to sway voters' opinions, force governments to intervene more frequently, and encourage looking inward and pursuing protectionists regimes. Governments have increased their incentives to boost the **domestic production of strategic goods** to reduce their exposure to global supply chain shocks. For example, the Biden administration recently ramped up efforts to boost **domestic production of electronic chips**. Federal Reserve chairman Jerome H. Powell spearheaded increase in interest rates, which would hurt the industry and could even lead to a housing-market collapse **and a recession**, but may mitigate troubles for households struggling from runaway prices and rents. The Indian government recently announced a **ban on wheat exports**, to enhance the country's food security. It also announced **a $1.2 trillion plan**, which amounts to a third of its gross domestic product, to bring home manufacturing activities from China. The newly elected British prime minister proposed tax cuts on the wealthy, presumably to spur growth, a move that has already **backfired**. In other words, governments are increasingly implementing steps that require the proverbial robbing of Peter to pay Paul.

These moves would appear contrary to Ricardo's free trade or Adam Smith's advocacy of "less is more" concept. Yet, they reflect the growing pains of helpless segments of the society. Transfers are increasingly essential to help those vulnerable segments of society whose problems the free market cannot solve, at least in the short run. Private charitable efforts such as the Bill & Melinda Gates Foundation are stepping up but can go only so far. Increasing complexity, heightened uncertainty, market failures, and severe shocks to the global economic system, make imperative the need for governments to intervene efficiently and judiciously.

To sum it all, the EU's move to tax windfall profits of energy companies, to support the most disadvantaged households and businesses as they brace for forthcoming European winters, simply reflects the growing imperative and needs of the time.

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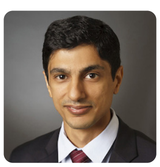

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